No. 73-1061

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MICHAEL RODAK, JR., C

In the Supreme Court of the United States

OCTOBER TERM, 1973

W. T. GRANT COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Pet. App. 1a-35a) are reported at 58 T.C. 290. The opinion of the court of appeals (Pet. App. 37a-46a) is reported at 483 F. 2d 1115.

JURISDICTION

The judgment of the court of appeals was entered on August 22, 1973. A petition for rehearing was denied on October 11, 1973 (Pet. App. 47a). The petition for a writ of certiorari was filed on January 7, 1974. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the court of appeals correctly held that petitioner's sales of books containing coupons which could

be exchanged for merchandise did not qualify for installment sale tax treatment under Section 453(a) of the Internal Revenue Code of 1954 and the Treasury Regulations promulgated thereunder.

STATEMENT

Petitioner is a corporation operating retail merchandising outlets throughout the United States. It provides its customers with three basic credit plans: (1) a traditional single-item installment plan, designated Special Purchase Installment Plan, under which the customer enters into a retail credit agreement for individual purchases and agrees to make designated monthly payments over a fixed period of time; (2) a typical revolving credit plan, designated 30-day Option Plan, under which the customer, using a credit card, makes purchases during the billing month and has the option of paying in full with no service charge or of paying ten per cent of the monthly balance plus a service charge calculated on the monthly balance outstanding; and (3) the Coupon Book Installment Plan, which is at issue here (Pet. App. 2a-6a, 39a-41a).

Under the Coupon Book Installment Plan, qualifying customers purchase coupon books redeemable for merchandise at any of petitioner's stores. The books range in value from $10 to $100 and contain coupons of varying small denominations. The books may be paid for in full or over a period of time (varying from four to eighteen months during petitioner's taxable years ended January 31, 1964, and January 31, 1965), pursuant to a retail credit agreement providing for monthly payments plus a time-price differential. Sales under the coupon book plan are deemed to occur when the coupons are exchanged for merchandise, not when the books are issued. Because petitioner does not keep records of coupon redemptions,

there is no means of correlating sales of merchandise items to the installment payments[1] (Pet. App. 4a-6a, 39a-41a).

Section 453 of the Code permits ratable reporting of gain from an installment sale which meets certain statutory and regulatory conditions. Under the installment method, the portion of each payment which represents taxable gain is computed by multiplying the amount of the payment by the percentage of profit on the sale.

One of the requirements for qualification under the installment method is that the sale be paid for in two or more payments. This requirement is explicitly set forth in Treasury Regulations, Section 1.453-2 (b)(2), Appendix, *infra*, which further states that the installment method is available for certain amounts received under revolving credit plans. With respect to such plans, Treasury Regulations, Section 1.453-2(d), Appendix, *infra*, establishes certain minimum record-keeping requirements that must be met to qualify revolving charge plans for installment reporting, including a detailed sampling method for determining what percentage of amounts paid under revolving charge plans would qualify for installment reporting.

The Commissioner determined that under the pertinent Treasury Regulations, sales made in exchange for coupons from the books did not qualify for installment treatment as installment sales because there was no record that the sales generated by exchange of the coupons were in

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[1]Although "sales" under the coupon credit plan are deemed to occur when coupons are exchanged for merchandise, petitioner records sales under the special purchase installment plan and the issuance of coupon books on the same form and does not distinguish between them for bookkeeping and accounting purposes (Pet. App. 6a, 41a).

fact paid for in two or more installments (Pet. App. 9a). The Tax Court upheld petitioner's claim to installment sale treatment, relying upon the "general concept" of installment sales. The court of appeals, however, reversed on the authority of the Regulations (Pet. App. 46a). As a result, petitioner, an accrual basis taxpayer, had to include in income the fair market value of the installment obligations upon their creation.

ARGUMENT

1. Section 453 of the Internal Revenue Code provides an installment method for ratably reporting gains from the sale of property over the years in which payments are received. The installment method is a relief provision, the basic purpose of which is to defer payment of tax on gains until the proceeds of sale with which to pay the tax have been received. However, since these relief provisions are exceptions to the general rule that an accrual basis taxpayer must include in income the value of all receivables, they must be strictly construed. See, *e.g., Baltimore Baseball Club, Inc.* v. *United States,* 481 F. 2d 1283 (Ct. Cl.); *Cappel House Furnishing Co.* v. *United States,* 244 F. 2d 525 (C.A. 6); *Prendergast* v. *Commissioner,* 22 B.T.A. 1259, 1262.

Under Treasury Regulations promulgated in 1963 pursuant to Section 453(a), a taxpayer is permitted to defer and report on the installment basis income derived from certain sales "on the installment plan" which qualify under one of two definitions. The first definition (Treasury Regulations, Section 1.453-2 (b)(1)) permits installment reporting of sales under any plan which "by its terms and conditions, contemplates that each sale" thereunder will be paid for in two or more payments. The second definition (Treasury Regulations, Section 1.453-2(b)(2)) allows installment treatment for certain of

the sales under a revolving credit plan or similar credit arrangement—which contemplates that sales of merchandise will be paid for in two or more payments, and "which sale[s] * * * in fact [are] paid for in two or more installments."

The Regulations set forth record-keeping standards which must be met in order to demonstrate what percentage of sales under the second definition "in fact" are paid for in two or more payments. Thus, with respect to revolving credit plans and similar extensions of credit, a taxpayer is required to furnish proof, in accordance with a prescribed sampling technique, of the percentage of his sales which, in fact, are paid for in two or more payments (and thus qualify under the statute) as opposed to those sales in which the customer merely charges purchases but does not utilize the revolving credit feature of the plan or incur a finance charge.

2. There is no question that these regulations are valid and that petitioner's coupon book plan does not qualify under them.

In 1964, Congress amended Section 453 of the Code by adding subsection (e), providing that the term "installment plan" includes revolving credit plans.[2] Later the same year, however, Congress repealed that provision retroactively[3] on the ground that the installment sale concept was such "that it would have been better to have left the Treasury Department with the opportunity to determine by regulation the extent to which sales under revolving credit

[2]See Section 222 of the Revenue Act of 1964, P.L. 88-272, 78 Stat. 75.

[3]See Section 3 of the Act of August 31, 1964, P.L. 88-539, 78 Stat. 746.

type plans are to be treated as sales under installment plans." S. Rep. No. 1242, 88th Cong., 2d Sess., p. 5. The Committee further noted (*ibid.*) that it intended that "the term 'sales on the installment plan' be interpreted by the regulations as covering 'sales on a revolving credit type plan' to the full extent provided in the regulations issued by the Treasury Department on October 15, 1963 * * *."[4]

In light of this history, there can be no question about the validity of these Regulations, which have been subjected to the scrutiny of the Congress and have received its express approval. See Internal Revenue Code, Section 7805(a); *United States* v. *Correll*, 389 U.S. 299, 307; *Commissioner* v. *Stidger*, 386 U.S.287, 296; *Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501. Thus, the court of appeals correctly determined that "[a]ny determination, therefore, of [petitioner's] qualifying for §453 treatment must be made in the context of the regulations" (Pet. App. 42a).

The court of appeals' further conclusion that petitioner's coupon books did not qualify for installment sale treatment is similarly correct. Pursuant to the coupon installment plan, a customer may obtain a coupon book worth, for example, $100, for which he agrees to make payments of $10 per month for 11 months. If he uses the entire coupon book immediately to make a large purchase, he has made a purchase that has been paid for

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[4]Prior to the promulgation of the Regulations, the district court in *Consolidated Dry Goods Co.* v. *United States*, 180 F. Supp. 878 (D. Mass.), held that a revolving credit plan came within the "ordinary meaning and the accepted trade meaning of the words 'installment plan'" (180 F. Supp. at 882). As a result, sales made under such a plan, even if only a single payment was made for an item, qualified for installment reporting. The regulations were issued in response to this decision.

in two or more installments. If he uses the coupons to make small purchases of $10 or less per month, however, no sale of merchandise will have been paid for in two or more payments. A plan permitting the latter pattern of purchases does not qualify under the Regulation's first definition of "installment plan," which requires that each sale be paid for in two or more installments.

Moreover, the court of appeals correctly held that petitioner's plan did not qualify under the second definition of the Regulations. That definition provides that sales made under an installment plan which in fact are paid for in two or more installments can qualify for installment reporting if such sales (or some proportion thereof) were in fact paid for in two or more payments. Petitioner, however, failed to comply with the record-keeping requirements of the Regulations, which are essential in order to establish the requisite factual basis for qualification under the second definition.

3. Contrary to petitioner's contention (Pet. 12-13), the decision below does not disqualify all coupon sales plans for installment treatment.[5] All it held was that, due to petitioner's accounting method, it could not meet the proof requirements of the Regulations, a conclusion that petitioner appears not to contest. In failing to "maintain accounting records in such a manner as to enable an accurate computation to be made * * * in accordance with" the record-keeping requirements of the Regulations, petitioner, as the court of appeals concluded,

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[5]Although petitioner argues (Pet. 13) that the issue is important to "not a small number of retailers," we are advised by the Internal Revenue Service that no cases are presently pending involving the question either in the courts or administratively.

"lost the protection of the traditional installment sales presumption of periodic payment" (Pet. App. 46a).

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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APPENDIX

§1.453-1 *Installment method of reporting income.*

(a) *In general.* (1) Section 453 permits dealers in personal property, that is, persons who regularly sell or otherwise dispose of personal property on the installment plan, to elect to return the income from the sale or other disposition thereof on the installment method. To the extent provided in paragraph (d) of § 1.453-2, sales under a revolving credit type plan will be treated as sales on the installment plan and the income from the sales so treated may be returned on the installment method. A dealer who makes sales of personal property under both a revolving credit plan and a traditional installment plan may elect to report only sales under the traditional installment plan on the installment method; or he may elect to report only sales under the revolving credit plan on the installment method; or he may elect to report both sales under the revolving credit plan and the traditional installment plan on the installment method. A traditional installment plan usually has the following characteristics:

(i) The execution of a separate installment contract for each sale of personal property, and

(ii) The retention by the dealer of some type of security interest in such property.

(2) The installment method may also be applied with certain limitations (see paragraph (c) of this section) to the sale or other disposition of real property and the casual sale or other casual disposition of certain personal property.

* * * * *

§1.453-2 *Special rules applicable to dealers in personal property.*

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(b) *Definition of sale on the installment plan.* The term "sale on the installment plan" means—

(1) A sale of personal property by the taxpayer under any plan for the sale or other disposition of personal property, which plan, by its terms and conditions, contemplates that each sale under the plan will be paid for in two or more payments, or

(2) A sale of personal property by the taxpayer under any plan for the sale or other disposition of personal property—

(i) Which plan, by its terms and conditions, contemplates that such sale will be paid for in two or more payments, and

(ii) Which sale is in fact paid for in two or more payments.

Normally, a sale under a traditional installment plan (as described in paragraph (a)(1) of §1.453-1), meets the requirements of subparagraph (1) of this paragraph. See paragraph (d) of this section for the application of the requirements of subparagraph (2) of this paragraph to sales under revolving credit plans.

* * * * *

(d) *Revolving credit plans.* (1) To the extent provided in this paragraph, sales under a revolving credit plan will be treated as sales on the installment plan. The term "revolving credit plan" includes cycle budget accounts, flexible budget accounts, continuous

budget accounts, and other similar plans or arrangements for the sale of personal property under which the customer agrees to pay each billing-month (as defined in subparagraph (6)(iii) of this paragraph) a part of the outstanding balance of his accounts. Sales under a revolving credit plan do not constitute sales on the installment plan merely by reason of the fact that the total debt at the end of a billing-month is paid in installments. The terms and conditions of a revolving credit plan do not contemplate that each sale under the plan will be paid for in two or more payments and thus do not meet the requirements of paragraph (b)(1) of this section. In addition, since under a revolving credit plan payments are not generally applied to liquidate any particular sale, and since the terms and conditions of such plan contemplate that account balances may be paid in full or in installments, it is generally impossible to determine that a particular sale under a revolving credit plan is to be or is in fact paid for in installments so as to meet the requirements of paragraph (b)(2) of this section. However, subparagraphs (2) and (3) of this paragraph provide rules under which a certain percentage of charges under a revolving credit plan will be treated as sales on the installment plan. For purposes of arriving at this percentage, these rules, in general, treat as sales under a revolving credit plan (1) which are of the type which the terms and conditions of the plan contemplate will be paid for in two or more installments and (2) which are charged to accounts on which subsequent payments indicate that such sales are being paid for in two or more installments.

(2)(i) The percentage of charges under a revolving credit plan which will be treated as sales on the

installment plan shall be computed by making an actual segregation of charges in a probability sample of the revolving credit accounts and by applying the rules contained in subparagraph (3) of this paragraph to determine what percentage of charges in the sample is to be treated as sales on the installment plan. (See subparagraph (5) of this paragraph for rules to be used if some of the sales under a revolving credit plan are nonpersonal property sales (as defined in subparagraph (6)(iv) of this paragraph).) Such segregation shall be made of charges which make up the balances in the sample accounts as of the end of each customer's last billing-month ending within the taxable year. (See subparagraph (6)(v) of this paragraph for rules to be used in determining which charges make up the balance of an account.) However, in making such segregation, any account to which a sale is charged during the taxable year on which no payment is credited after the billing-month within which the sale is made (hereinafter called the "billing-month of sale") and on or before the end of the first billing-month ending in the taxpayer's next taxable year shall be disregarded and not taken into account in the determination of what percentage of charges in the sample is to be treated as sales on the installment plan. In order to obtain a probability sample, the accounts shall be selected in accordance with generally accepted probability sampling techniques. The appropriateness of the sampling technique and the accuracy and reliability of the results obtained must, if requested, be demonstrated to the satisfaction of the district director. If the district director is not satisfied that the taxpayer's sample is appropriate or that the results obtained are accurate and reliable, the taxpayer shall recompute his sample percentage or make appropriate adjustments to his

original computations in a manner satisfactory to the district director. The taxpayer shall maintain records in sufficient detail to show the method of computing and applying the sample.

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